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Recommendation for a

COUNCIL RECOMMENDATION TO SLOVAKIA

with a view to bringing an end to the situation of an excessive government deficit

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(4) The Council has decided on [2 December2009], in accordance with Article 104(6), that an excessive deficit exists in Slovakia.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1] (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances. In deciding whether special circumstances exist, “relevant factors” as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account. Furthermore, in a recommendation to correct an excessive deficit the Council should

[1] OJ L 209, 2.8.1997, p. 6.

request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.

(6) Special circumstances, which are relevant for the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, are deemed to exist in the case of Slovakia. In particular, being a very open economy, Slovakia has been severely affected by the global crisis, primarily through a strong fall in external demand. Real GDP contracted by 11% quarter-on-quarter in the first quarter of 2009. The second quarter of 2009 brought signs of stabilisation but, according to the Commission services' 2009 autumn forecast, real GDP is expected to contract by 5.8% in 2009. Economic activity is projected to pick up gradually in 2010, when real GDP is projected to grow by 1.9%, reflecting the improvement in the global environment. The existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework.

(7) According to the Commission services' autumn 2009 forecast, the deficit is expected to deteriorate by 4 percentage points to 6.3% of GDP in 2009. This mainly reflects the impact of the economic crisis on government finances. The stimulus measures adopted by the Slovak government in response to the crisis and in the context of the EERP will not have any effect on the general government deficit in 2009 as they are being financed through reallocations within the budget. Based on the no-policy change assumption, the Commission services' autumn 2009 forecast projects the deficit to remain high in 2010 and 2011, at 6% and 5.5% of GDP, respectively. In response to the widening deficit, the Slovak government approved in September 2009 a three-year budget for 2010-2012, which envisages consolidation of public finances starting from 2010. According to these plans, the government deficit will be reduced to 5.5% of GDP in 2010, 4.2% of GDP in 2011 and 3% of GDP in 2012. The proposed budget is, however, subject to risks. Uncertainties on the expenditure side reflect a lack of sufficient specification of measures needed to achieve the adjustment path, a track record of expenditure overruns, and the absence of enforceable expenditure rules.

(8) Considering the special circumstances and the EERP framework, an average annual structural budgetary adjustment is recommended. The required adjustment should take into account the fiscal room for manoeuvre which is assessed on the basis of all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In calculating the average annual adjustment, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total structural adjustment needed to reach the nominal deficit target of 3% by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

(9) Against this background, it is appropriate to consider the correction of the excessive deficit in a medium-term framework, taking into account the path approved by the Slovak government in the 2010-2012 budget and associated risks, and with a deadline for the correction by 2013. In particular, in view of the size of the 2009 deficit, and of Slovakia's economic outlook, a credible and sustainable adjustment path would require the Slovak authorities to, first, implement the deficit reducing measures in 2010 as planned in the 2010-2012 draft budget; second, in order to bring the deficit below 3%

of GDP in 2013, achieve an average annual structural budgetary adjustment of 1% of GDP over the period 2010-2013. The government will need to specify the necessary measures in order to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and it should accelerate the reduction of the deficit if permitted by better-than-expected economic or budgetary conditions.

(10) The general government debt ratio declined by over 14 percentage points of GDP from 2003 on reaching 27.7% of GDP in 2008. In view of the crisis and subsequent widening of the general government deficit in 2009, the Slovak authorities notified in October 2009 gross general government debt at 30.4%. The Commission services' 2009 autumn forecast projects further deterioration of the general government debt ratio to 42.7% in 2011 due to a persisting high deficit and a sluggish economic recovery.

(11) Slovakia has a multi-annual budgetary framework with three-year budgetary planning. Deficit targets set out in the past convergence programmes have been achieved mainly due to stronger-than-expected economic performance. However, expenditure plans outlined in the medium-term budgetary frameworks have always been exceeded in the past and subsequently revised upwards. In view of this experience, it is important to strengthen the enforceability of the medium-term budgetary framework.

(12) As regards the long-term sustainability of public finances, the budgetary position in 2009 compounds the impact of population ageing, which is slightly below the EU average, on the sustainability gap. Improving the primary balance over the medium term should contribute to reducing the high risks to the long-term sustainability of public finances.

(13) Enhanced surveillance under the EDP, which seems necessary also in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of the Slovak stability programme which will be prepared between 2010 and 2012 could usefully be devoted to this issue.

(14) In general, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy. In particular, the Slovak authorities should carry out reforms conducive to enhancing the quality of public finances, in particular the quality of public procurement. They should also undertake reforms supporting reallocation of expenditures towards education, R&D and innovation, and to improve business-research cooperation. In addition, the Slovak authorities should step up efforts to reduce administrative burdens on businesses and implement reforms to make progress in the implementation of the lifelong learning strategy and to address skill mismatches.

(15) In addition, in view of importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Slovakia should also ensure that budgetary consolidation towards MTO is sustained after the excessive deficit will have been corrected.

HEREBY RECOMMENDS:

(1) Recognising that stimulus measures financed through reallocation within the budget amounting to 0.4% of GDP in 2009 were an adequate response to the European Economic Recovery Plan, and that consequently the worsening of the fiscal position in 2009 resulted from the free play of automatic stabilisers, the Slovak authorities should put an end to the present excessive deficit situation by 2013.

(2) The Slovak authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Slovak authorities should:

  (a) implement the deficit reducing measures in 2010 as planned in the draft budget for 2010-2012;

  (b) ensure an average annual structural budgetary adjustment of 1% of GDP over the period 2010-2013;

  (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(3) To limit risks to the adjustment, Slovakia should strengthen the enforceability of its medium-term budgetary framework as well as improve the monitoring of the budget execution throughout the year, in particular to avoid expenditure overruns compared to budget plans.

(4) The Council establishes the deadline of 2 June 2010 for the Slovak government to take effective action to implement the deficit reducing measures in 2010 as planned in the draft budget for 2010-2012 and to outline the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The Slovak authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

Furthermore, the Council invites the Slovak authorities to implement reforms with a view to raising potential GDP growth. This includes reforms conducive to enhancing the quality of public finances, in particular the quality of public procurement. The Council also invites the Slovak authorities to undertake reforms supporting reallocation of expenditures towards education, R&D and innovation, and to improve business-research cooperation. In addition, the Slovak authorities are invited to step up efforts to reduce administrative burdens on businesses and implement reforms to make progress in the implementation of the lifelong learning strategy and to address skill mismatches.

This recommendation is addressed to the Slovak Republic.

Done at Brussels,

For the Council
The President